P-Card: A Payables Tool

Presented by PNC Bank
April 28, 2010
Agenda

- Introductions
- Payment Processing: Options/Trends
- Value Proposition
- Program Types
- Controls/Reconciliation
- Card Acceptance
- Questions
Introductions

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Payables Challenges

- **Working Capital Strain**
  - Funding delays
  - Decreased funding sources – increased enrollment
  - Budget gaps

- **Technology**
  - Increased focus on automation/technology

- **Resource Strain**
  - Staffing Reductions

*Current challenges offer the “OPPORTUNITY” to review/reengineer current payables process*
Electronification of the U.S. Payment System

- **Federal Reserve Payment Study** (total non-cash payments 2003 vs. 2006)
  - Overall 6.4% decline in presented checks (4.1% decline in checks written plus 2.3% impact of conversion)
  - 18.6% increase in ACH payments
  - 17.9% increase in debit card and 4.6% increase in credit card transactions

- **Aberdeen ePayables Benchmarking Survey** (change in B2B payments during the past 2 fiscal years)
  - Reported 5.3% decline in check-based transactions
  - 9.7% increase in ACH payments
  - 8.2% increase in pcard transactions, 6.7% increase in T/E card transactions

- **Phoenix Hecht 2008 Cash Management Monitor**
  - Reviewed payment mix by company size
  - Check decline and respective acceleration of ACH most pronounced in largest corporations

<table>
<thead>
<tr>
<th>Revenue</th>
<th>Check</th>
<th>ACH</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $100m</td>
<td>77%</td>
<td>12%</td>
<td>11%</td>
</tr>
<tr>
<td>$100 - 500m</td>
<td>71%</td>
<td>16%</td>
<td>13%</td>
</tr>
<tr>
<td>&gt; $500m</td>
<td>59%</td>
<td>24%</td>
<td>17%</td>
</tr>
</tbody>
</table>
Trends Affecting Payment Processing

- Sarbanes-Oxley (section 404) prompts heightened focus on internal controls associated with payment processes
- Increased focus on reducing “cost to process”
- Check fraud and related risk mitigation costs
- Consolidation of multiple invoices → reducing check issuance volume
- Internet penetration enables distributed workflow solutions
- System upgrades
- Growth of e-Commerce procurement solutions
- Introduction of on-line auctions
- Increased acceptance and utilization of purchase cards in B2B space
  - Enhanced level of Point of Sale data capture
  - Visa Large Ticket Interchange program
Pcard Trends

- Use of cards continues to grow as a significant element of companies’ overall procurement and payment strategy
- Cards now viewed as a preferred payment alternative – as compared to check, wire and ACH
- Use of cards has evolved beyond petty cash replacement and T/E facilitator

**Typical spend categories**
- Maintenance, Repair, Other (MRO)
- Office Supplies
- Office Equipment
- Technology
- Temporary Employment
- Courier
- “Events/Conferences”
- Courier
- Support services – cab/limo, florists, gifts, subscriptions, catering, exterminator, locksmith, security monitoring, training, bottled water
- Emergency production needs – equipments repairs or supplies needed to keep production lines operational (current emergency check requests)

**Card usage beginning to extend beyond indirect spend to include COGS expense**
Planned Card Utilization

Identifying and collecting meaningful and complete level 2 and level 3 data can increase spend reductions 1.3% to 5.5% via sourcing and compliance effectiveness.

Source: Aberdeen Group/National Association of Purchase Card Professionals
Value Proposition
Material differences in the economics of the various payment alternatives create the opportunity to pursue an optimum payment mix and a winning proposition.

### AVERAGE TRANSACTION COST

<table>
<thead>
<tr>
<th>Payment Method</th>
<th>Incremental Revenue Share*</th>
<th>Incremental Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>Card</td>
<td>$5.00</td>
<td></td>
</tr>
<tr>
<td>ACH</td>
<td></td>
<td>$0.125</td>
</tr>
<tr>
<td>Check</td>
<td></td>
<td>$0.63 (bank fees + mail delivery)</td>
</tr>
<tr>
<td>Wire</td>
<td></td>
<td>$8.41</td>
</tr>
</tbody>
</table>

* Assumes average transaction size of $1,000 and rebate of 50 bps
Relative Rebate Structures (General)

Capturing revenue from the interchange economics is a compelling factor in program evaluation….

<table>
<thead>
<tr>
<th>Program Scale</th>
<th>Rebate*</th>
<th>Profile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic</td>
<td>1.25 - 1.30%</td>
<td>e-Settlement Approach - Vendor Integration</td>
</tr>
<tr>
<td>Large</td>
<td>0.75 - 1.10%</td>
<td>Aggressive Centralized Spend - Some Strategic Vendor applications</td>
</tr>
<tr>
<td>Medium</td>
<td>0.45 - 0.75%</td>
<td>Established Program - Some Centralized Spend in Traditional Categories</td>
</tr>
<tr>
<td>Small</td>
<td>0.25 - 0.45%</td>
<td>Traditional Small Dollar Program - decentralized purchases, T&amp;E</td>
</tr>
</tbody>
</table>

*industry averages for consolidated T&E, MRO and Vendor spend

Rebate Structures are typically determined based on a number of often complex factors, including but not limited to; the volume of spending activity, number of cards, transaction sizes, the types of technology deployed to meet reporting and control requirements, settlement terms, payment cycles, method of payment, credit strength of program sponsor, etc…
Working Capital and Payment Float Impacts

Card-Based Settlement

Traditional Check Payment

CUSTOMER CASH BALANCE

Alternate vendor payment with credit card on same terms as former check payment (r/30): Billing cycle cuts off on the 15th day with settlement with PNC 5 days thereafter.
Value Proposition - Summary

- **Processing Efficiency** – industry averages point to gains of $5-10/payment
  - All-in procurement and payment
  - Payment only

- **Reduction in Payment Execution Costs**
  - Bank check clearing, reconciliation and control
  - Postage
  - Check stock

- **Sharing of Interchange Fee Revenue**
  - Percentage of aggregate card-based volume
  - Tiered by relative annual program spend

- **Cash-Flow Impacts from Extended Payment Float**
  - 30 day billing cycle plus 7 day payment terms (up to 21 day payment terms if desired)

- **Other**
  - Information to leverage trading relationships
  - Vendor satisfaction – payment cycle acceleration, guaranteed payment
  - Employee satisfaction – procurement empowerment and cycle time acceleration
  - Enhanced management spend visibility
Program Types
Program Types
Holistic Use of a Variety of Procurement/Payment Solutions

Companies capturing greatest percentages of transactions and spend have multiple card programs.

- **Employee Purchasing cards**
  - For smaller dollar decentralized purchasing
  - Reduces time for receipt and payment of goods
  - A lot of value for both buyer and vendors

- **Employee Travel cards**
  - For travel & entertainment expenses
  - Preferred method of payment for these vendors
  - Improves financial controls (SOX compliance)

- **Vendor Ghost cards**
  - For preferred (contract) vendor ordering
  - Facilitates online ordering and payment
  - A lot of value for both buyer and vendors

- **Card-Based Settlement**
  - For payments requiring backend approval
  - Enables card settlement on PO’s
  - Less value to vendors
## Program Types
### Point of Purchase Vs. Point of Payment Strategies

<table>
<thead>
<tr>
<th>Account Issuance</th>
<th>Distributed Cards</th>
<th>Ghost Cards</th>
<th>Card-based Settlement</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Physical cards held by employees</td>
<td>16 digit account # housed by vendor</td>
<td>16 digit account #</td>
</tr>
<tr>
<td>Spending Limit</td>
<td>Monthly discretionary maximum</td>
<td>Monthly discretionary maximum</td>
<td>$0 – incremented by approved amounts only</td>
</tr>
<tr>
<td>Other Controls</td>
<td>MCC, transaction size, frequency</td>
<td>MCC, transaction size, frequency</td>
<td>MCC, transaction size, frequency</td>
</tr>
<tr>
<td>Card Presentment</td>
<td>Point of Purchase</td>
<td>Charged upon Fulfillment/ Service Delivery</td>
<td>Upon receipt, approval and payment decisioning – push and pull options</td>
</tr>
<tr>
<td>Transactions Served</td>
<td>Non P.O. indirect spend, travel &amp; entertainment</td>
<td>Selected centralized vendor relationships – air travel, overnight courier, supplies, temp’s</td>
<td>Strategic spend requiring continued procurement, receiving and approval processes</td>
</tr>
<tr>
<td>Accounting</td>
<td>Mixture of default mapping, cardholder reconciliation and export</td>
<td>Centralized reconciliation assisted with cost center or department ID passed with transaction record</td>
<td>Existing approval and accrual process unchanged – payable relieved when approved and file sent to Bank</td>
</tr>
</tbody>
</table>
Program Types
Distributed Employee Purchase and Travel Cards

- **Buyer** submits order and presents card for payment
- **Supplier** fills order and processes payment against card
- Transaction posts to Bank
- **Cardholder Reconciliation**
- Accounting Reviews & Closes Transaction in Bank system

**Key Benefits:**
- Internal efficiency
- Increased control over petty cash and other exception purchasing needs
- Moderate rebate/reward potential
- Cardholder benefits – car rental, luggage, ADD insurance
- Guaranteed payment
- Accelerated fulfillment cycling

**Batch Created & Exported**
**ERP**
**Converted file imported to A/P or GL**
Program Types
Traditional Distributed Solution

- Physical distribution of cards to selected employees and locations
- Transaction information captured at point of sale and passed through to your bank’s *web-based* application
- Default accounting allocation can be assigned based both on hierarchy and merchant profile
- Alternative web-based workflow for cardholder allocation and manager review
- Transaction details can be exported in a variety of formats for integration within a company’s general ledger
- Integration with expense and accounting systems
- Monthly settlement with bank – xx days following pre-defined billing cycle
**Program Types**
**Ghost Card Solutions**

- Centralizing account processing with ability to allocate to respective purchasers/departments
- Significant value from vendor’s perspective
- Importance of effective reconciliation
Program Types
Traditional Ghost Card

- Rather than physical card presentation, a vendor specific account number is provided to strategic suppliers.
- In order to assist the reconciliation process, suppliers typically pass supplemental information in the Customer Referenced ID field – cost center, purchase order, G/L coding.
- Reference data provided by purchaser at time of ordering/service request.
- Transaction is processed at point of shipment/service delivery (likely acceleration in payment by purchasing company).
- Generally centralized in Purchasing.
- Supplier enrollment/acceptance work typically required by Purchasing.
- Key consideration – need for cost effective review and reconciliation process. Typically need to integrate receiving validation and define a process for controlling returns/missing items.
Program Types
Card-based Settlement Solutions

Current Process Remains the Same

Push Settlement
- Funds directed to suppliers established merchant service account
- Electronic remittance advice directed to supplier
- Supplier funded in 24 hours

Pull Settlement
- Approved funds added to dedicated supplier card account
- Electronic remittance advice directed to supplier
- Supplier processes along with other card transactions
- Supplier funded in 24 hours
- Company manages approved payments which remain outstanding

- Retention of current sourcing, approval and payment decisioning
- Significant increase in card penetration of overall spend ... resulting interchange revenue sharing potential
- Natural extension in payment terms
- Elimination of check-based execution costs: postage, banking fees, etc.
Program Types
Card-based Settlement

- Solution assists clients with the conversion of their accounts payable payments from check to electronic card payments
- Current procurement, receiving and decisioning remains unchanged
- Transactions with participating vendors can be exported for integration and payment
- Application archives unique vendor account numbers to settle payments
- An electronic remittance advice is created and delivered to the vendor
- The account is funded with only the approved payment amount
- Completed transactions can be exported and cleared against a company’s general ledger
- Opportunity to penetrate more strategic spend
Controls / Reconciliation
Technology and Reconciliation Process
Reconciliation and Interface Options

Web-based Reconciliation and Export

- Transaction post
- Default Coding
- Cardholder Recon
- Data Export
- ERP upload

- Options to capture and pass point of sale coding with CRI
- Company rules based on MCC or hierarchy
- Cardholder validation, over-ride or transaction split
- Optional Manager review & approval
- Template to customize output file elements
- CSV, TXT, HTML, etc

Transaction Data Transmission

- Transaction post
- Default Coding
- Data Transmission
- ERP upload
- Recon

- Options to capture and pass point of sale coding with CRI
- Company rules based on MCC or hierarchy
- DEF, Statement bill and EDI 811
- Daily, weekly frequency
- Can include pre-population of expense mgt system for T/E
- Additional coding, validation and workflow performed with enterprise system
Workflow Solutions

- **Transaction review and Approval**
  - Optional post purchase/submission review and approval of all cardholders assigned to respective hierarchical group
  - Ability to review and edit submitted details, coding, etc.

- **Purchase Log**
  - Optional approval rules for P-log requisitions ... ability to define dollar limits (all or only those in excess of prescribed amount)

- **Accounts Payable**
  - Approval of new vendor set-up
  - Ability to mimic organizational signatory rules
  - Approval of manual payment authorizations
Controls
Risk Mitigation/Compliance Considerations

❖ **Active Fraud Monitoring**
  • Proactive risk review of submitted transactions based on both past cardholder history and pre-determined criteria queues (i.e. ATM withdrawal or purchase activity within various intervals, purchase combinations)

❖ **Liability Waiver Coverage**
  • Provider insurance coverage addressing cardholder misuse
  • Covers posted transactions surrounding notification of termination

❖ **Traditional Point of Sale Controls**
  • Merchant category blocking
  • Transaction size and frequency
  • Monthly discretionary spending limit

❖ **Management Visibility into Spend**
  • Next day visibility into processed transactions
  • Reporting of potential exception activities
  • Audit logging and reporting of cardholder entitlement changes

❖ **Other**
  • Optional post purchase routing and approval
  • Dispute and charge backs
  • Card Verification Value (CVV) other card protections
Issues Impacting Pcard Adoption

- Vendor acceptance and/or related pricing impacts
- Perceived loss of control
- Complexity with integration of receiving functions in a card-based process
- System or process requirements for Purchase Order approval and execution for all transactions
- Integration of transaction data with ERP system
- Cardholder reconciliation compliance
- Sales and Use tax compliance
- Relative level of transaction data captured and available for card-based purchases (Level I, II and III)
Survey of Card Accepting Suppliers
Primary Factors Leading to Acceptance

- Customer request or demand: 91%
- Faster payment: 70%
- Guaranteed payment: 70%
- Ongoing vendor relationships: 55%
- Competitive pressure: 39%
- Other: 2%

2008 PNC CIB Card Acceptance Study
Survey of Card Accepting Suppliers
Vast Majority Accept Without Adjustment to Terms

Different Payment Terms for Card Payments

Types of Terms
- Cards only accepted at point-of-sale or at invoice
- No discounts offered
- Additional fees assessed/Different pricing structure
- Payment must be made in advance/at delivery

2008 PNC CIB Card Acceptance Study
Significant Financial Benefit derived from direct expense savings (as opposed to “soft dollar process savings) and revenue incentives that grow and recur each year of the program.